ONTARIO SECURITIES COMMISSION

PERSPECTIVES

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inside...

Perspectives, as well as other information about the Ontario Securities Commission, is available on the OSC Web site: *www.osc.gov.on.ca.*

FEATURE

The OSC's Current Agenda: Accounting and Financial Reporting

In a well-publicized recent speech to the annual Business Leaders Luncheon of the Institute of Chartered Accountants of Ontario (available on the OSC Web site at *www.osc.gov.on.ca*), OSC Chair David Brown expressed concern at an apparent erosion of public confidence in audited financial statements. In a period in which public involvement in capital markets has never been so strong, he emphasized how critical it is to maintain confidence in the relevance and reliability of financial information provided by reporting issuers.

The regular provision by reporting issuers of reliable financial information is fundamental to the efficient working of the capital markets. Financial statements are certainly not the only source of information used by investors in making investment decisions, but they continue to be invaluable as an accessible, summarized presentation of an enterprise's financial position and the results of its activities. The annual examination by the auditor plays a crucial role in adding credibility to the overall picture conveyed by those financial statements.

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POLICY PROFILES

An overview of policy initiatives and where they stand in the policy development and implementation process.

Rule Published on Alternative Trading Systems

In July, the Canadian Securities Administrators (CSA) published proposed rules, policies and other materials that will provide a framework for regulating trading systems, including Alternative Trading Systems (ATSs). The CSA believe that the proposed framework will allow ATSs to compete with traditional exchanges without the negative effects of market fragmentation.

"Most market participants believe the time has come to allow ATSs to compete with traditional exchanges."

ATSs are automated matching systems that bring together orders from buyers and sellers, by using predetermined, established methods or rules under which the orders interact. To date in Canada, ATSs have only been allowed to operate as members of existing exchanges because of concerns about market fragmentation. However, most market participants believe the time has come to allow ATSs to compete with traditional exchanges.

Among the highlights of the proposed regulatory framework is a plan to consolidate traditional marketplaces (exchanges) with new marketplaces (ATSs) to provide a consolidated Canadian market. The consolidation plan provides for the collection, consolidation and dissemination of quote and trade information. The purpose is to integrate all markets to provide buyers and sellers with access to the best price available at the time of execution.

The proposal also provides ATS service providers with a choice as to how they wish to be regulated:

- As an exchange
- As a member of an existing exchange, or
- As a dealer and member of a Self-Regulatory Organization.

Following a period for comment and final approval by CSA members, the final rules will be published. It is anticipated that ATSs will begin to come on stream in Canada by mid-2000.

For more information, please call **Randee Pavalow**, Manager, Market Regulations (416) 593-8257.

22 OSCB July 2 (ATS Supplement)

Rule on General Prospectus Requirements

On July 23, 1999, the OSC published in a special OSC Bulletin a Notice of Proposed Changes to proposed Rule 41-501 General Prospectus Requirements, proposed Companion Policy 41-501 CP General Prospectus Requirements, and proposed Form 41-501F1 Information Required in a Prospectus. The proposed Rule is a local rule that consolidates various provisions currently set forth in the Regulation to the Securities Act (Ontario) and in various policy statements and notices of the OSC and staff concerning the preparation, certification, filing and receipting of preliminary prospectuses and final prospectuses. The changes are based in part on comments received after the long form prospectus instruments were initially published in 1997. In addition, as it is intended that the proposed Rule, Companion Policy and Form parallel, to the extent possible, the substantive provisions of proposed National Instrument 44-101 – Prompt Offering Qualification System, it was decided that these long form instruments would be revised and the comments addressed when the National Instrument was being revised.

Although the proposed Rule is a local rule, staff has sought participation from the other members of the CSA in hopes that the OSC's local rule will be adopted nationally. Attempts have been made to align the proposed Rule and proposed Companion Policy with the consensus views being developed at the CSA level amongst the accountants with respect to financial reporting issues. As a separate but parallel initiative, a committee formed of various members of the CSA is in the process of reviewing and updating the material contained in the OSC Corporate Finance Accountants Practice Manual. As a result of this ongoing CSA harmonization effort, notices regarding the long form prospectus instruments were published for comment in certain other CSA jurisdictions.

"With very few exceptions, the proposed Rule does not distinguish between the preliminary and final prospectus in connection with the age of the financial statements."

Among the most significant changes being proposed are:

- With very few exceptions, the proposed Rule does not distinguish between the preliminary and final prospectus in connection with the age of the financial statements. Interim financial statements must be included for the most recent interim period ended more than 60 days from the date of the prospectus, and annual financial statements must be included for the year(s) ended more than 90 days from the date of the prospectus. These timeframes apply to both the preliminary and final prospectus.

- The financial reporting requirements in the case of guaranteed offerings have been amended to conform to proposed National Instrument 44-101 so that limited relief is provided for issuers where the guarantor owns, directly or indirectly, 100% of the issuer. The concept of a guarantor has also been expanded to a "credit supporter".

"The proposed Form now provides more extensive instructions including an instruction to use simple, clear language and avoid jargon."

- Comments are specifically being requested on a CSA proposal to permit "junior issuers" (an issuer whose revenue, assets, shareholder equity and market capitalization are all less than $5 million) to provide only one year of audited financial results and two years of unaudited results in lieu of three years of audited financial statements.
- The extent of financial statement disclosure for an acquired business is determined on the basis of the significance of the acquisition to the issuer's business. The significance is determined by three tests (asset test, revenue test, net income from continuing operations test) with reference to a sliding scale (similar in principle to the Securities and Exchange Commission's Rule 3-05(b) of Regulation S-X under the Securities Act of 1933). The more "significant" the acquisition is to the issuer, the more historical financial information about the acquired business that is required.
- The proposed Rule permits financial statements of non-Canadian issuers to be prepared in accordance with foreign GAAP if the foreign GAAP is as comprehensive as Canadian GAAP. The notes to the financial statements must include a reconciliation to Canadian GAAP which describes the effect of the material differences that relate to measurement and provides disclosure consistent with Canadian GAAP. Issuers must file a letter from the auditor discussing the auditor's expertise to reconcile foreign GAAP to Canadian GAAP.
- The proposed Rule permits the use of a foreign auditor's report provided the report is accompanied by a statement by the auditor confirming that the auditing standards applied are substantially equivalent to Canadian GAAS and commenting to Canadian readers on any material differences in the form and content of the foreign auditor's report as compared to the Canadian auditor's report. A letter must be filed discussing the auditor's expertise to make the determination that foreign GAAS is substantially equivalent to Canadian GAAS.
- The proposed Rule introduces the ability to do a non-fixed price offering of any securities provided a rating from an "approved rating organization" has been obtained and disclosed.
- Related credit supporters (defined as an affiliate of the issuer) are required to certify the prospectus. Credit supporters that are not related credit supporters are treated under the proposed Rule in essentially the same fashion as other experts and must file a consent.
- Only material contracts that create or materially affect the rights and obligations of holders of the securities being distributed are required to be filed and will be made publicly available by the OSC.
- The proposed Form now provides more extensive instructions including an instruction to use simple, clear language and avoid jargon. The proposed Companion Policy reiterates this instruction and provides guidance regarding plain language principles. The proposed Form requires disclosure of all penalties and sanctions imposed against directors, officers, promoters and controlling shareholders of an issuer or the terms of any settlement agreement entered into by such persons with a regulator subject to a materiality limitation.

For more information, please call **Susan Wolburgh Jenah**, General Counsel (416) 593-8245, **Kathy Soden**, Director, Corporate Finance (416) 593-8149, **Julie Bertoia**, Sr. Accountant (416) 593-8083, or **Rossana Di Lieto**, Legal Counsel (416) 593-8106.

Proposed National Instrument 44-101 and Related Instruments - Short Form Prospectus Distributions

The CSA has published for comment proposed changes to the proposed instruments on the Prompt Offering Qualification System (NI44-101). The new proposed instruments, now called "Short Form Prospectus Distributions", incorporate a number of changes made since the instruments were first published for comment in 1998.

The purpose of the proposed instruments is to reformulate National Policy 47 (NP 47) and to continue to allow issuers to access Canadian capital markets rapidly, while maintaining current levels of investor protection and public disclosure.

Among the most significant changes made to the proposed instruments that were published in 1998 are:

1. **Financial Statement Disclosure for Significant Acquisitions**
   The extent of financial statement disclosure for an acquired business is to be determined on the basis of the significance of the acquisition to the issuer's business. The significance is determined by three tests (asset test, revenue test, net income from continuing operations test) with reference to a sliding scale (similar in principle to the Securities and Exchange Commission's Rule 3-05(b) of Regulation S-X under the Securities Act of 1933. The more "significant" the acquisition is to the issuer, the more historical financial information about the acquired business that is required.

2. **MRRS**
   The anticipated adoption of National Policy 43-201 Mutual Reliance Review System for Prospectuses (MRRS) is reflected.

3. **Renewal AIFs - Definition of "current AIF"**
A renewal AIF will no longer be "accepted for filing". A renewal AIF becomes a "current AIF" upon filing. The requirement that the regulator decide within 10 days of filing whether to review a renewal AIF has been omitted to permit the regulator greater flexibility in determining whether to review an issuer's renewal AIF.

4. **Non-Fixed Price Distributions**
Any type of securities may now be distributed at non-fixed prices, provided that they are rated, rather than only specified types of securities.

5. **Credit Supporters - Certificate or Consent**
Related credit supporters (defined as affiliates of the issuer) are required to certify the prospectus. Credit supporters that are not related credit supporters are treated under the proposed Rule in essentially the same fashion as other experts and must file a consent.

6. **Definitions of "approved rating" and "approved rating organization"**
The definition of "approved rating organization" has been expanded by adding Duff & Phelps Credit Rating Co., Fitch IBCA, Inc. and Thomson Bank Watch, Inc. The "approved rating" definition has been revised to refer to only the minimum rating categories required, as opposed to listing all of the acceptable categories.

7. **Promoters**
There is a new requirement in the proposed Short Form Prospectus form for disclosure concerning a person or company that is, or has been, within the two years immediately preceding the date of the preliminary short form prospectus, a promoter of the issuer or of a subsidiary of the issuer.

8. **Certificates for Non-corporate Issuers**
The certificate requirement has been expanded to permit, in cases where no CEO or CFO has been appointed, certificates of persons acting on behalf of an issuer in a capacity similar to a CEO and to a CFO.

Summary of Other Major Changes to NP 47

In addition to the changes discussed above, the following major changes, among others, have also been made to NP 47 and were first reflected in the 1998 proposed Instruments:

- The timing of the application of the public float test has changed such that the test must be satisfied on a date within 60 days before the filing of the preliminary short form prospectus.

- The expansion of the qualification criteria applicable to distributions of guaranteed non-convertible securities is expanded to include cash settled derivatives.

- The qualification criteria applicable to distributions of guaranteed non-convertible securities has changed such that the requirements that the guarantor have approved rating securities outstanding and that the securities being distributed have an approved rating have been omitted where the guarantor satisfies the $75,000,000 public float test.

- The qualification criteria applicable to distributions of guaranteed convertible securities has changed such that the requirements that the guarantor have approved rating securities outstanding and that the securities being distributed have an approved rating have been omitted on the basis that the guarantor is required to satisfy the $75,000,000 public float test.

- The concept of "alternative credit support" in the qualification criteria applicable to distributions of guaranteed securities has been added.

- Qualification criteria specifically applicable to distributions of asset-backed securities, as a result of which the shelf system will be available for such distributions, has been added.

For more information, please call **Joanne Peters**, Senior Legal Counsel, (416) 593-8134

22 OSCB July 23 (POP Supplement)

Rule 56-501 on Restricted Shares

The OSC has made and delivered Rule 56-501 to the Minister of Finance for approval. The Rule will provide holders of restricted shares and prospective purchasers of restricted shares with similar rights to those previously available to them under OSC Policy 1.3. If the Minister does not approve, reject or return the Rule to the Commission for further consideration, it will come into force on October 25, 1999. If the Minister approves the Rule, it will come into force 15 days after it is approved.

The Commission made an earlier version of the Rule in 1997 and submitted it to the Minister of Finance for approval. The Minister returned it to the OSC, however, for further consideration of its jurisdiction to make a rule that assigns voting rights to securities that are otherwise non-voting through the minority approval provisions contained in Part 3 of the Rule.

The proposed Rule now incorporates a number of changes. In particular, the Commission has amended its earlier definition of minority approval. The effect of this change is that holders of restricted shares that are not entitled to vote under corporate law will not, under the Rule, receive a vote on a proposed reorganization or stock distribution, and holders of restricted shares that are not given a class vote at corporate law will not receive a class vote under the Rule.

For more information, please call **Joanne Peters**, Senior Legal Counsel, (416) 593-8134.

22 OSCB August 13, page 5005

US Broker-Dealers Exemption from Registration

In October 1997, the CSA released for comment a proposed National Instrument on Conditional Exemption from Registration for United States Broker-Dealers and Agents (NI 35-301). The NI would provide US broker-dealers and their agents with a conditional exemption from the applicable registration and prospectus requirements under Canadian securities legislation. This would facilitate certain cross-border trading in foreign securities between US broker-dealers and US clients who are in a Canadian jurisdiction.

Based on comment letters, the CSA has decided that two reciprocity issues should be resolved before it implements the National Instrument. First, the SEC has published proposed rules that would provide registration relief to Canadian dealers and their salespersons similar to that provided to US broker-dealers and their agents under the NI. The CSA is awaiting the final SEC rules to ensure they provide sufficient reciprocal relief.

Second, the CSA believes that in order for sufficient reciprocity to be achieved, certain additional states in the US must adopt rules that provide relief substantively similar to that provided under the NI and the North American Securities Administrations Association resolution on this issue.

For more information, please call **Dirk de Lint**, Legal Counsel, (416) 593-8090.

22 OSCB July 16, page 4319

OSC REPORTS

An inside look at Commission developments and projects that will have an impact on the investment community.

OSC Names Director of Capital Markets

William Gazzard has been named Director of the Capital Markets Branch at the OSC. Mr. Gazzard was formerly with Gordon Capital Corporation where he was General Counsel and a Director. Prior to joining Gordon Capital, Mr. Gazzard was Associate General Counsel and a Director at Nesbitt Thomson Inc. He has also served as Director of the Regulatory Policy Divisions within the Member Regulation Department at The Toronto Stock Exchange. Mr. Gazzard was called to the Ontario Bar in 1981.

Capital Markets is responsible for regulation of registrants, investment products, markets and clearing and settlement systems. The Capital Markets Branch encompasses the Market Regulation, Compliance, Registration and Investment Funds groups.

Recent Hearings

The staff of the OSC has recently been involved with three matters of interest to a broad audience of market participants.

Provigo Inc.– Early this year, Provigo Inc. sought Exemptive Relief from certain continuous disclosure requirements. As the principal jurisdiction under the Mutual Reliance Review System (MRRS), Quebec granted the relief. Ontario and British Columbia opted out of the MRRS for this application. OSC staff recommended a compromise: if Loblaw, which holds all the common shares of Provigo, guaranteed Provigo's debentures, the Commission would grant relief from the requirement that Provigo prepare and file its interim and annual financial statements, Form 28 and AIF on condition that summarized financial information about Provigo was provided in Loblaw interim financial statements in a note to its audited annual financial statements. Provigo did not agree with this condition and applied for complete relief from the disclosure requirements. The OSC held a hearing on the matter in June, denying Provigo's application and supporting the OSC staff's proposed compromise. Reasons were issued in the July 23rd OSC Bulletin.

JDS Uniphase Canada Ltd. – The OSC heard an appeal by JDS Uniphase Canada Ltd. on July 22 regarding the Director's decision on an application relating to a proposed public offering of exchangeable shares. The shares proposed to be issued would be exchangeable for common shares of JDS Uniphase Corporation, a United States corporation. JDS Uniphase Canada's preliminary prospectus incorporated by reference financial statements of JDS Uniphase Corporation, prepared in accordance with US generally accepted accounting principles. These statements were not reconciled to Canadian generally accepted accounting principles, as required by the Regulation. JDS Uniphase Canada had applied for relief from the reconciliation requirement and the Director had denied the relief. Following the hearing, the Commission confirmed the Director's decision refusing to grant relief in this matter. Reasons were issued in the August 13th OSC Bulletin.

Crystallex International Corporation – The OSC released a decision in the matter of Crystallex on April 20th. In this decision, the Commission considered two questions referred to it by the Director. The questions related to whether the issue of convertible securities by Crystallex under a preliminary short form prospectus to a single purchaser, Standard Bank London Limited (SBL), in satisfaction of Crystallex's loan repayment obligations to SBL (the Repayment Rights), is effectively a distribution of the underlying securities (the Common Shares) to public investors.

During the hearing, Commission staff expressed the view that the issue of the Repayment Rights by Crystallex to SBL, the issuance of Common Shares to SBL pursuant to the Repayment Rights, and the resale by SBL of Common Shares into the secondary market is one distribution such that the ultimate purchasers, being those that acquired Common Shares in the secondary market from SBL, should

receive a prospectus and the associated rights. The Commission concluded that the Director was correct in determining that it would be contrary to the public interest to permit Crystallex to use the technical device of qualifying the Repayment Rights by prospectus as a means of circumventing the general requirements for delivery of a prospectus to the true purchasers. Reasons were issued in the April 30th OSC Bulletin.

For more information, please contact **Iva Vranic**, Manager, Corporate Finance, (416) 593-8115, **Margo Paul**, Manager, Corporate Finance, (416) 593-8136, or **Heidi Franken**, Manager, Corporate Finance, (416) 593-8249.

Dialogue with the OSC

On October 26th, the OSC will hold its annual conference "Dialogue with the OSC".

The event will take place at the Westin Harbour Castle Hotel in Toronto. The focus for the day's program will be the OSC Statement of Priorities and will highlight initiatives that the Commission, along with other securities regulators, is working on to improve the efficiency of the Canadian regulatory regime. The cost to attend the event is $295.00.

For more information or to register for "Dialogue with the OSC", call (416) 593-7352.

For a copy of the agenda and to register online, visit the OSC Web site at *www.osc.gov.on.ca*.

Securities Investigators Training Course

Every two years, the Enforcement Branch hosts the Securities Investigators Training Course, a five-day event designed to familiarize securities professionals with various methods of investigating and prosecuting securities violations. This year the course was held from June 14th to June 18th.

Since 1975, the course has been held at the Kempenfelt Centre in Barrie. This year's agenda included Internet Fraud, Arbitration and Dispute Resolution, the Upstairs Market, Telemarketing Fraud, Market Manipulation, Money Laundering and Informant Development. Speakers were invited from the TSE, the SEC, the RCMP, law firms and consultants.

Recent IOSCO Publications

Staff of the OSC participate in working parties organized by the Technical Committee of the International Organization of Securities Commissions (IOSCO). The Technical Committee recently published reports prepared by two working parties that will be of interest to some of the OSC's constituents:

- *"Securities Lending Transactions: Market Development and Implications"*, a Joint Report by the Technical Committee and the Committee on Payment and Settlement Systems, July 1999.
- *"Regulatory Approaches to the Valuation and Pricing of Collective Investment Schemes"*, Report of the Technical Committee, May 1999.
- *"CIS Unit Pricing"*, Report of the Emerging Markets Committee, May 1999.
- *"A Comparison Between the Technical Committee Report and the Emerging Markets Committee Report on Valuation and Pricing of Collective Investment Schemes"*, Joint Report of the Technical Committee and the Emerging Markets Committee, May 1999.

The reports are available on the IOSCO Web site *www.iosco.org* or in printed format, for a nominal charge, from the IOSCO General Secretariat. The General Secretariat's address is noted on the Web site.

CANADIAN SECURITIES ADMINISTRATORS

A summary of recent national initiatives from the Canadian Securities Administrators (CSA). The CSA is comprised of the thirteen securities regulators of the provinces and territories of Canada.

Strategic Plan 1999-2001

Harmonizing securities regulation will be a key priority for the Canadian Securities Administrators in the years 1999-2001, according to their recently published Strategic Plan.

Harmonizing initiatives that the CSA will pursue include:

- building investor awareness, knowledge and competence through shared education initiatives;
- updating rules and policies for mutual funds;
- developing a "single-entry" prospectus and application filing and review system predicated on a functioning and effective mutual reliance system;
- jointly supervising national self-regulatory organizations/developing a "single entry" Canadian registration system based on a high-functioning mutual reliance system;
- moving toward a common regulatory approach to electronic and other alternative trading systems (ATSs); and
- formulating options and alternatives for a Canadian integrated disclosure system.

The CSA notes that it has already progressed considerably in developing many common rules, policies, approaches and systems. Examples include:

- regulation of alternative trading systems;
- creation of mutual reliance systems for review of applications for discretionary relief, prospectus review, and review of applications for registration of advisors and SRO dealers;
- establishment of a central electronic system for insider reporting;
- establishment of the System for Electronic Document Analysis and Retrieval (SEDAR);

- harmonization of escrow rules of Initial Public Offerings;
- harmonization of hold periods across CSA jurisdictions;
- development of self-regulatory organizations;
- development of a shared training program for use by staff members at all Securities Regulatory Authorities (SRA);
- alignment of most individual Commission planning cycles and processes with those of the CSA;
- shared attention to and regular interchange on the Year 2000 challenge faced by all SRAs; and
- open sharing of Commission plans and reports in direct support of improved resource sharing and streamlined operations.

Key Challenges

In their plan, the CSA note a number of important challenges that will impact all of the securities administrators in the coming years. Among them are:

- global integration of markets and the rapid pace of technological change;
- the increasing dominance of the secondary market and rapid growth of the market for investment funds;
- addressing gaps in financial services regulation;
- building a "Canadian Securities Regulatory System", within available resources, which reflects local concerns, priorities and legislation;
- public confidence in the integrity of Canada's markets; and
- development of varying business structures for the securities regulatory authorities.

Summing up the Strategic Plan for 1999-2001, the CSA

"Provide effective deterrence of abusive, unfair and fraudulent practices through aggressive and coordinated enforcement."

identify their "core" strategies as the following:

1. Continue to build and administer the Canadian Securities Regulatory System.
2. Build and sustain a high level of investor confidence and competence through a strong public voice and education initiatives.
3. Play an active and leading role in helping markets respond adequately to the Year 2000 issue.
4. Provide an effective regime for existing, alternative and emerging trading systems.
5. Provide an effective regulatory framework for supervising the distribution of investment products and advice.
6. Provide effective oversight of self-regulatory organizations.
7. Provide effective deterrence of abusive, unfair and fraudulent practices through aggressive and coordinated enforcement, harmonized legislative empowerment (where possible) and clear, compelling and effective administrative order, civil remedies and quasi-criminal penalties.

For more information, please call **Kathleen Finlay**, Manager, Project Office (416) 593-8125.

22 OSCB July 2, page 4047

Distribution Structures Paper Published

The CSA has published a Position Paper on distribution structures that will have a significant impact on the manner in which certain registrants organize and conduct their business operations.

The paper sets out both acceptable and not-acceptable distribution structures — that is, how securities firms organize their businesses. Among the structures deemed unacceptable are the payment of commissions to an unregistered corporation, and the use of independent contractors.

"Non-traditional structures do not always satisfy the regulatory concerns regarding effective supervision of salespersons, legal responsibility to the client, and access to books and records."

Under the traditional structure, a dealer markets and delivers its services through its partners, officers, and/or employees. The dealer's liability for the actions of its salespersons and its duty to supervise the actions of those salespersons is clear. There has been, however, pressure from the securities industry to allow the use of non-traditional structures. In some cases, firms have already implemented these structures. These non-traditional structures do not always satisfy the regulatory concerns regarding effective supervision of salespersons, legal responsibility to the client, and access to books and records.

The CSA Committee reviewed six specific subjects: dual employment, securities sold under exemptions, trade names, referral arrangements and commission splitting, financial planning activities by registrants, and the legal relationships that exist between dealers and their salespersons.

Dual Employment: Dual employment will be allowed, provided that the salespersons' other employment does not interfere with their duties and responsibilities as salespersons and provided that the dealer is responsible and liable for all of the financial service activities of the salespersons that are not subject to another regulatory regime.

Securities Sold Under Exemptions: Restricted dealers and salespersons will be permitted to sell only those securities for which they are expressly registered, as well as deposit instruments and government debt instruments.

Trade Names: Trade names and trademarks will be permitted to accompany, but not replace, the full legal name of the dealer on materials that are used to communicate with the public, provided that the following condition, and others specified in the Position Paper, are met: all trade names and trademarks through which a salesperson conducts registerable activities and financial service activities that are

not subject to another regulatory regime must be registered to the dealer.

Referral Arrangements and Commission Splitting: Referral arrangements will be permitted only between dealers or between dealers and entities that are licensed or registered under some other regulatory system that is acceptable for the purpose of referral arrangements ("acceptable entity"), and then only if certain conditions specified in the Position Paper are satisfied. These conditions include the requirement that there be a written agreement governing the payment of referral fees between the dealers, or the dealer and the acceptable entity. The agreement cannot be between the salespersons themselves.

Financial Planning Activities by Registrants: Salespersons who provide financial planning services must do so through the dealer that sponsors their securities registrations. They must also comply with certain other requirements that are detailed in the Position Paper, including the requirement that salespersons must satisfy minimum proficiency standards.

Acceptable Business Structures
Dealer as employer and salespersons as employees, or dealer as principal and salespersons as agents: A structure wherein the dealer is the employer and the sales force is composed of employees is acceptable. Where the dealer is the principal and the salespersons are agents, the structure will also be acceptable, but only if the conditions set out in the Position Paper's discussion of salespersons as agents are satisfied.

Service provider business structure: Unregistered corporations may provide certain services to a dealer and its salespersons, provided that the conditions discussed in the Position Paper are satisfied. Those conditions include the requirement that the dealer's ultimate responsibility and liability to clients must not be affected by these arrangements.

Introducing and carrying dealer model: Dealers may only enter into arrangements involving multiple corporations when all of those corporations are registered in an appropriate category of dealer or the arrangement is in accordance with the service provider model.

Independent contractor: Salespersons will not be permitted to carry out their financial service activities on behalf of a dealer where they are acting as independent contractors.

Incorporation without registration: Subject to the discussion above concerning *Introducing and Carrying Dealer Structures and Service Provider Structures*, salespersons will not be allowed to incorporate in order to conduct registerable activities and financial service activities that are not subject to another regulatory regime.

For more information, please call **Jennifer Elliott**, Legal Counsel, (416) 593-8109, or **Irene M. Tsatsos**, Senior Accountant, (416) 593-8223.

Proposal to Introduce Statutory Civil Liability for Continuous Disclosure in Canada

Early in 1999, staff members for the securities commissions in Ontario, British Columbia, Alberta, Saskatchewan and Quebec (the CSA Civil Remedies Committee) presented a report to the CSA Chairs which summarized the comments received in response to draft legislation published for comment on May 29, 1998 that would, if adopted, introduce a limited statutory civil liability regime in respect of secondary market disclosure. The staff report included a proposed approach for moving this legislative initiative forward which the CSA Chairs endorsed. The CSA Civil Remedies Committee is proceeding to reconsider the draft legislation, taking into account both formal and informal comments received since its publication.

The Committee has also been reviewing and comparing existing Canadian provincial class action regimes and has met with outside counsel to discuss various aspects of civil procedure particularly in the context of class action litigation in Canada and the US. The Committee is also reviewing recent legislative changes in the United States which were intended to address perceived abuses in securities class action litigation against publicly held companies as well as the development of the case law under Rule 10b-5 of the Securities Exchange Act of 1934. If material changes are made to the legislative proposal, the CSA may publish it for comment again.

For more information, please call **Susan Wolburgh Jenah**, General Counsel (416) 593-8245, or **Rossana Di Lieto**, Legal Counsel (416) 593-8106.

SEDAR Updates

A new version of the SEDAR Filer Software (Release 6.0) was released in September. The new requirement that electronic filers file all documents exclusively in PDF format will become effective with the implementation of Release 6.0.

The CSA recently implemented a number of other amendments to the SEDAR Instrument. The amendments eliminate certain definitions and other items contained in the Definitions Instrument (NI 14-101) because they are no longer needed in the SEDAR Instrument. Another change incorporates by reference the most recent version of the Filer Manual in the SEDAR Instrument to avoid the need to amend the Instrument each time a new version of the Manual is released.

For more information, please call **Karen Eby**, SEDAR Project, (416) 593-8242.

Trust Accounts for Mutual Fund Securities

CSA staff has published a notice designed to assist dealers in complying with section 12 of National Policy 39, which deals with commingling of money by mutual fund dealers and securities dealers. The notice grew out of staff observations when conducting compliance field reviews of inappropriate practices related to the use of trust accounts.

The staff notice discusses matters including designating a trust account; commingling of funds; allowable expenses against trust account interest; advancing funds to clients; reconciliations and internal controls; and requirements in British Columbia. The notice was published in the May 14th issue of the OSC Bulletin.

For more information, please call **Irene M. Tsatsos**, Senior Accountant, (416) 593-8223.

22 OSCB May 14, page 2939

ENFORCEMENT

The following are summaries of recent enforcement proceedings and hearings before the Commission. For more information, please call the OSC at (416) 593-8314.

The Crabbe Huson Group, Inc.

On August 10, 1999, the Ontario Securities Commission (the "Commission") announced that it had approved a settlement reached by staff of the Commission in a proceeding brought against The Crabbe Huson Group, Inc. ("Crabbe Huson").

In April of 1996, Crabbe Huson, an investment management firm based in Portland, Oregon, began purchasing common shares of Lytton Minerals Limited ("Lytton"), a Canadian corporation whose common shares traded on The Toronto Stock Exchange.

By May 4, 1998, it had acquired an aggregate of 29,872,000 common shares of Lytton, representing approximately 25.87% of the outstanding common shares of Lytton. Crabbe Huson purchased these shares on behalf of its managed accounts.

In the Settlement Agreement, Crabbe Huson admitted that it had contravened the take-over bid requirements, early warning reporting requirements and insider trading reporting requirements in Parts XX and XXI of the *Ontario Securities Act* (the "Act") in connection with its acquisition of the common shares of Lytton, and that such conduct was contrary to the public interest.

Under the terms of the settlement, Crabbe Huson paid a total of US$120,000 to the Commission, in trust, to be allocated by the Commission to third parties for purposes that will benefit investors in Ontario. The settlement payment represented disgorgement of the profit earned by Crabbe Huson from management fees charged to its managed accounts, attributable to the holdings of Lytton common shares by such accounts in excess of 10% of the Lytton common shares when outstanding. In addition, Crabbe Huson made a payment in the amount of Cdn.$40,000 representing a contribution towards the cost of staff's investigation of this matter.

Marchment & MacKay Limited et al

On July 16, 1999, the Ontario Securities Commission (the "Commission") released its decision in the matter of Marchment & MacKay Limited et al ("Marchment"). The hearing in this matter commenced on June 22, 1998 and concluded on June 24, 1999. During the course of 38 hearing days, staff of the Commission (staff) presented evidence to support allegations that the above-named Respondents failed to deal fairly, honestly and in good faith with their clients and that they engaged in high-pressure sales techniques to sell speculative penny stocks without regard to the suitability of the investment needs of the client.

In its decision, the Commission stated: "We have concluded that Marchment has, since January 1993, engaged in extensive campaigns to sell speculative penny stocks from its inventory by telephone through numerous salespeople without regard to the suitability of the trades to the needs of its clients. These campaigns have been conducted in a manner intended to induce the customer to make a hasty decision to buy the security being offered without disclosure of the risks inherent in the investment or disclosure that an integral part of Marchment's selling campaign is the establishment by Marchment from time to time of the trading price of the securities." The Commission further found that Charles Lorne Ornstein and Amit James Sofer conceived and implemented this aspect of Marchment's business and that Jerry Murray Saltsman, Gregory Charles Osborne and Fraser John Edward Plant were each knowing and willing participants in these campaigns. As such, the Commission held that the individual Respondents had failed to deal fairly, honestly and in good faith with Marchment's clients.

Accordingly, the Commission ordered that:

(a) the registration of Marchment & MacKay Limited be terminated permanently;
(b) registration of the company's president and principal shareholder, Charles Lorne Ornstein, be terminated for life;
(c) the registration of the company's vice-president and compliance officer, Amit James Sofer, be suspended for 10 years;
(d) the registration of Jerry Murray Saltsman, salesperson, be terminated for life;
(e) the registration of Gregory Charles Osborne, salesperson, be suspended for 7 years; and
(f) the registration of Fraser John Edward Plant, salesperson, be suspended for 5 years.

Martin Shefsky

The Ontario Securities Commission (the "Commission") approved a Settlement Agreement entered into between staff of the Commission and Martin Shefsky in which Mr. Shefsky undertook not to apply to the Commission for registration for a period of ninety days, and agreed that if he applied after ninety days and such application was approved, his registration would be subject to terms and conditions ensuring that his activities would be closely supervised. The Commission also issued a reprimand to Mr. Shefsky.

The agreed statement of facts in the Settlement Agreement stated that Mr. Shefsky controlled a private corporation known as Toreal Holdings Limited ("Toreal"). Toreal held a controlling interest in Evans Health Group ("Evans"), a publicly traded company. Mr. Shefsky admitted that Toreal engaged in prohibited transactions in shares of Evans. In addition, Toreal failed, on a number of occasions, to comply with its obligation to file insider and other reports required by Ontario securities law. Staff and Mr. Shefsky agreed that these breaches were inadvertent and were not for any improper purpose.

Regal Goldfields Limited

On June 11, 1999, the Ontario Securities Commission (the "Commission") publicly announced its decision to close its investigation into trading in shares of Regal Goldfields Limited ("Regal"). The Commission does not generally make such announcements, however; as it had earlier confirmed that it was reviewing a complaint about the matter, the Commission felt it was appropriate that the decision to close the subsequent investigation be made public.

Staff of the Commission ("staff") was investigating allegations of insider/tippee trading prior to the release of the Nova Scotia government's decision to remove protected wilderness status from certain lands in Nova Scotia and permit mineral exploration and possible mine development on those lands. Staff found no basis for the allegation that there was improper trading in shares of Regal prior to publication of the government's decision.

(The OSC's Current Agenda)

Maintaining and enhancing the credibility of financial information required from reporting issuers is an item that is high on the Commission's current agenda.

In part, public concern about the credibility of published information has been accentuated by a few high profile situations in which fraud or misconduct has been determined/alleged. While these situations are clearly of concern to the Commission, our primary focus is on whether generally accepted accounting principles (GAAP) and generally accepted auditing standards (GAAS) are being applied appropriately. Our concerns in this regard are influenced by several environmental factors that may affect behaviour or shape perceptions. First, in an environment in which share prices can decline dramatically on the basis of earnings in a single quarter, the escalating pressure on management to meet market expectations creates considerable temptation to distort earnings. Second, we have a growing concern about the real and perceived threat to the independence of the auditor where significant non-audit services are provided to audit clients. This concern becomes more pronounced as public accounting firms expand into providing a wider range of professional services and the audit practice contributes a lesser proportion of income.

More so than in the United States, Canadian accounting standards have historically tended to set out basic principles rather than detailed rules, implicitly relying on the professional judgment of management and auditors to achieve the optimum balance between objectivity and adaptability. The experience of staff suggests that this balance is slipping. In our review of financial statements, we encounter regularly situations in which reporting issuers, apparently supported by their auditors, stretch the interpretation of accounting standards beyond all reasonable limits. Conclusions are based on narrow interpretations of standards without regard to their broader context. Standards are treated more like narrowly written rules rather than broad principles requiring the exercise of sound professional judgment in their application. This "loophole mentality" fails to achieve what The Macdonald Commission, in its report on the public's expectations of audits, characterized as "a fair and reasonable interpretation of the spirit of the standard". We believe this goal is one for which preparers and auditors alike should strive.

"The Commission, however, will not remain as an observer from the sidelines if the quality of financial reporting appears to be eroding."

Commission members and staff, investors and analysts alike are expressing a growing frustration that a number of problems appear to be not only persisting but flourishing. In some cases, the issue is overstatement of current income, perhaps by use of aggressive and inappropriate revenue recognition practices, in others it may be understatement of current income through excessive "one time" charges that have the effect of making future earnings look better. A significant part of the responsibility for addressing these issues lies with the accounting profession. The Commission relies

first on the Canadian Institute of Chartered Accountants to establish appropriate accounting and auditing standards and second on the public accounting firms who audit the financial statements of reporting issuers to enforce rigorously those standards. The Commission, however, will not remain as an observer from the sidelines if the quality of financial reporting appears to be eroding.

The recent founding of our Continuous Disclosure Team represents a key step in increasing our presence in the area of financial reporting. Over time, this team will lead a rebalancing of staff resources to ensure adequate review of financial information in the context of continuous disclosure documents as opposed to offering documents. This group ultimately will aim to review the statements of the majority of public issuers on a periodic basis, as well as targeting issues raised by current transactions, media reports, or other sources. The continuous disclosure group will also work on longer-term strategic initiatives - such as a review of disclosure practices of issuers - to ensure that information is disclosed to the marketplace as a whole rather than selectively, or a review of the overall quality of Management's Discussion and Analysis (MD&A).

"Our primary goal is to improve the quality of financial reporting, but we are also fully prepared for a more active role to lead to a greater number of accounting-related enforcement actions. Of course, violations of specific requirements in individual standards provide obvious bases for such actions."

For issuers this will mean that they should fully expect to find themselves challenged more frequently on accounting matters, whether or not they have recently filed a document offering securities. Our primary goal is to improve the quality of financial reporting but we are also fully prepared for a more active role to lead to a greater number of accounting-related enforcement actions. Of course, violations of specific requirements in individual standards provide obvious bases for such actions. Beyond this, however, staff increasingly will be aggressive in pursuing accounting treatments that, while not addressed explicitly in existing standards, are not clearly supportable by reference to the body of accounting literature as a whole, including fundamental accounting concepts. Staff will not hesitate to question some of the diverse treatments followed in practice that we believe are not fully justifiable in relation to the underlying accounting concepts. Our efforts will be concentrated on addressing key areas of accounting inconsistency. When necessary, staff will work with the Commission to consider the appropriateness of using its rulemaking powers to address problem areas within GAAP.

Staff will also consider other elements of the financial reporting environment, such as the role of the Audit Committee in contributing to effective oversight by the Board of Directors. The Audit Committee has a vital role in promoting the independence of the auditor and ensuring high quality financial reporting. As the financial reporting process becomes ever more complex, an effective Audit Committee needs to understand fully the implications of key decisions made by management in preparing financial statements.

We will continue to emphasize to the accounting profession the importance of ensuring an effective compliance and disciplinary process. In appropriate cases, the Commission will be prepared to convene a hearing to examine the conduct of an auditor. This could lead to a reprimand of the individual or firm, a factor that would be taken into account by the Director in deciding on the future acceptability of an individual or firm as an auditor of financial statements filed with the Commission.

The accounting profession in Canada is a self-regulating profession, and the Commission is in many ways predisposed to respect its autonomy. The Commission's primary responsibility, however, is to safeguard the strength, vigour and integrity of our capital markets. In discharging this mandate, we intend to work closely with appropriate professional and standards-setting bodies. Issuers and investors can expect, however, that the Commission and its staff increasingly will be prominent in moving forward our agenda with respect to maintaining and enhancing the credibility of financial reporting in the public markets.

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